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C O N F I D E N T I A L SECTION 01 OF 02 ABU DHABI 002930

SIPDIS

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SUBJECT: SECURITY DOMINATES THE UAE FEDERAL BUDGET

Classified by Ambassador Michele Sison for reasons 1.5 (b &d).

¶1. (C) Summary: Funding for security (including defense) is the single largest portion of the 2004 federal budget and makes up a full 43 percent of budgeted expenditures. This figure does not include an unknown amount of other defense spending that is directly paid by the Emirate of Abu Dhabi. Although the lack of transparency in "who is funding what and for how much," makes budget analysis challenging, we are seeing a shift in emphasis in the UAE's security spending from facing conventional external threats like Iran to border security and counter terrorism. We can also see how strongly the Emirate of Abu Dhabi dominates the federal government as the controller of the "purse strings." Abu Dhabi contributes the lion's share of the funding for the federal budget and determines how much of it is spent. Although UAE President Zayed ratified the country's 2004 federal budget on August 22, 2004, it only makes up a portion of the country's overall spending. The strength of the federal government is largely dependent on Abu Dhabi's support -- and willingness to pay for -- a stronger federation. End Summary.

Abu Dhabi's Show  
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¶2. (C) UAE president Sheikh Zayed bin Sultan Al-Nahyan ratified the federal budget on August 22, with spending set at USD 6.5 billion and revenues at around USD 5.91 billion. The appointed Federal National Council approved the budget at the end of May and passed it to the rulers of the various emirates for approval. Abu Dhabi Emirate plays a much bigger role in total government spending than does the federal government. Abu Dhabi's expenditures make up about three quarters of the UAE's consolidated government spending, which includes federal and emirate level spending. Abu Dhabi contributes at least 55 percent of the federal government's revenues. It also controls how much of that money is spent. We understand that over half of Abu Dhabi's contributions to the federal budget are counted as "federal services," paid directly by the government of Abu Dhabi but recorded on the federal budget. The federal government has no control over how these federal services are spent, or even if they are spent in the categories reported. Ministry of Finance Assistant Under Secretary for Revenue and Budget Khalid Al-Bustani (protect) explained that Abu Dhabi tells the Ministry of Finance how much it is spending in a certain budget item. The UAEG never actually sees the money, but merely records the spending in the federal budget. Adding further opacity, Abu Dhabi also has budget outlays on national type projects -- such as defense or assistance to the northern emirates - - that are not recorded as federal expenses.

#### Defense Spending Stable, but Shifting Focus

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¶3. (C) One of the largest items in the federal budget (USD 2.7 billion) is security and justice. We have heard that between USD 1.6 billion and USD 2 billion is earmarked for defense spending. We also understand that all new UAE military acquisitions are considered off budget and that the Emirate of Abu Dhabi also funds defense related expenditures directly. According to Al-Bustani, defense spending is not controlled by the UAEG. With the exception of the salaries of the small Ministry of Defense, which supports the titular Minister of Defense Sheikh Mohammed bin Rashed Al-Maktoum (who has no role in day to day decisions), Abu Dhabi pays all defense expenditures. The Ministry of Finance officials tell us frankly that they do not know how the money is used or what part of the total defense bill it makes up.

¶4. (C) The sheer size of the security portion of the federal budget indicates its importance to the UAE, especially considering that the budget does not capture the Emirate of Abu Dhabi's spending on defense. Security and justice spending are up by less than three percent from the 2003 federal budget and we do not yet have a breakdown of how much of that increase is defense related. We do believe, from our conversations with UAE officials and U.S. defense contractors, that the UAE has shifted its defense priorities toward border security and counter terrorism. For example, the UAE is building a wall on the border with Oman and Saudi Arabia. It is looking for security and surveillance packages for its land and sea borders and for its offshore oil facilities. The UAE also moved about 5,000 troops from its land forces to the ministry of interior for a frontier corps. All of these factors lead us to believe that we are seeing a shift in the UAE's security emphasis.

#### What little the Feds Control

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¶5. (C) The federal budget makes up about a quarter of total government spending. (Note: Because Abu Dhabi funds the federal government, this figure represents some double counting with Abu Dhabi's budget.) About 40 percent of the federal government's revenues come from fees and from profits on state owned enterprises like Etisalat. Al-Bustani told EconChief that Etisalat was the federal government's largest independent source of revenue. The

UAEG is not only the majority shareholder in Etisalat, but also collects fees from what was a registered monopoly. The announcement, therefore, that the UAEG was breaking Etisalat's monopoly status caught several people by surprise. The UAE subsequently announced that it would hold a majority stake in any new telecom service provider, probably to balance revenue concerns with efforts to liberalize the sector.

16. (C) Al-Bustani said that the UAEG focused on the parts of the budget that it did control, including education, health, infrastructure, and salaries for civil servants. The UAEG is working with the various ministries to ensure that they abide by performance based budgeting to justify their expenditures.

What does it mean?

7 (C) The UAE is the ultimate experiment in "state's rights," with certain authorities and responsibilities ceded to the federal government and others to the individual emirates. Oil and gas revenues belong to the individual emirates, not the federal government. As the Emirate of Abu Dhabi owns 95 percent of the UAE's oil reserves, it dominates the seven-emirate federation. The federal government has the second largest budget in the UAE, but very few independent sources of income. Funding constraints keep the federal government weak compared to the Emirate of Abu Dhabi. In the last 5 years, federal revenues have only increased from USD 5.5 billion to USD 5.9 billion and spending has only increased by about a billion dollars. The UAEG and its spending, do play a vital role in strengthening the federation. This is largely, however, because Abu Dhabi supports a stronger federation, and is willing to pay for it. Abu Dhabi earns and spends more money than the other six emirates combined, spending much of that on "federal" issues.

Sison